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C O N F I D E N T I A L SECTION 01 OF 02 AMMAN 008133

SIPDIS

TREASURY FOR DEMOPULOS

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TAGS: [EFIN](#) [PGOV](#) [JO](#)

SUBJECT: SHEMAILEH SCANDAL BANKS BACK FROM THE DEAD

REF: A. 2002 AMMAN 687

[1](#)B. 2003 AMMAN 793

Classified By: Charge d'Affaires David Hale for reason 1.4 (b)

[1](#)1. (C) SUMMARY: Jordan is clearing up the final residue of a 2002 scandal involving hundreds of millions of dollars in unsecured bad loans to 31-year-old businessman Majed Al-Shemaileh (Ref A). The Shemaileh fiasco brought down the former head of Jordan,s General Intelligence Directorate, pushed Jordan National Bank (at the time the country's second largest) close to the brink, and, finally, forced two other banks into insolvency. This last legacy is slowly being resolved. Jordan Gulf Bank, which has been renamed Jordan Commercial Bank (JCB), has been relaunched and looks to be on its way to a relatively successful year. The other, Philadelphia Investment Bank (PIB), is only now beginning to generate a pre-launch buzz. The resurrection of both banks demonstrates the current health of the Jordanian economy, but runs counter to the GOJ,s stated goal of rationalizing its small, fragmented banking industry. END SUMMARY

[1](#)2. (C) The rebuilding of both JCB and PIB has been a root-and-branch affair. Neither was a healthy bank even prior to the Shemaileh scandal. JCB had been having problems as early as the mid-1980s, when it was merged with two other failing banks and given a large interest-free loan to help partially cover the non-performing loans it was inheriting from the other failing banks. PIB was set up more recently, but from the outset, it had a reputation as a bank "for money launderers." Central Bank of Jordan (CBJ) Governor Umayya Touqan claims that CBJ inspectors "always knew there were problems" in both banks from the early 1990s. Shemaileh,s activities, by contrast, began only in 1996. Re-launching both banks has therefore meant that the GOJ has needed to deal with preexisting problems in both banks, as well as addressing the corporate governance issues that led to the scandal itself.

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JCB SPREADS ITS WINGS  
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[1](#)3. (SBU) The JCB relaunch has not been an easy process. It has been possible only through substantial assistance from governmental and quasi-governmental bodies, a reminder of how invested the GOJ is in the saving of this bank. A substantial GOJ discount on an outstanding interest-free loan from the CBJ, dating to 1985 and originally intended to cover lost interest from JCB,s non-performing loans, allowed JCB to rid itself of JD 41 million (U.S.\$58 million) in debt to the GOJ for a price of JD 9 million (U.S.\$13 million). In addition, JCB has received a new loan of JD 21 million (U.S.\$30 million) interest-free from the CBJ. An injection of JD 30 million (U.S.\$42 million) in new capital, anchored by Jordan,s Social Security Corporation (SSC) but also contributed to by several of the bank,s original investors (including Saudi magnate Nasser Al-Salih), has strengthened the paid-up capital base of the restructured bank and allowed it to meet the CBJ minimum capital requirement, which has been relaxed for JCB for a period of five years.

[1](#)4. (SBU) These changes in the balance sheet of JCB and the selection of Jawad Hadid, a former Minister of Planning who has led three other banks previously and is known as something of a turnaround specialist for ailing banks, have created substantial market confidence in the new entity. The bank,s stock price has risen to match this new confidence, increasing from 1 JD at the time the restructuring plan was announced to 1.8 JD today. The SSC, which now holds 25 percent of the bank and will have two representatives on the bank,s board of directors, views the 80% return on its investment to date as having been a signal success.

[1](#)5. (SBU) Hadid, whose resigned in August 2003 as head of the Social Security Investment Commission (SSIC) in protest at political meddling in the SSIC,s investment decisions, might disagree with the SSC,s assessment. If so, however, he is showing no sign of such disagreement. He has ambitious plans for JCB to move strongly into the retail market, increasing the number of branches (17 already exist). He also plans to

set up an investment company within the JCB, and is looking to obtain a license either alone or with partners. JCB is enhancing its IT infrastructure as well, and will connect even its three West Bank branches electronically to the headquarters. Overall, Hadid believes that on current trends, JCB will double the modest JD 2.8 million (US \$4 million) profit that it had set as a goal in the bank's business plan for 2004.

16. (SBU) Hadid also claims that the new structures he has put in place will prevent a repetition of the lack of internal accountability that brought the bank down. JCB has brought in consultants to analyze the bank's strengths and areas of risk, and has outsourced both its internal audit (the first Jordanian bank to do so) and its marketing. Finally, Hadid is putting in place strong measures to separate the Board from the management of the bank and thereby reduce the scope for conflicts of interest.

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MARKET EYES PIB  
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17. (SBU) PIB's situation differs somewhat from JCB. Though the CBJ initially looked for larger, more financially sound institutions to take over both JCB and PIB, it quickly found that such banks were reluctant to become involved with either bank. The merger terms of Arab Bank, GOJ's early candidate as a white knight for JCB, were "ridiculous," according to Hadid, and the potential for success within JCB was great enough that with some painful restructuring, it could and did become attractive to investors and the Arab Bank option could be dropped.

18. (C) The condition of PIB, on the other hand, is so bad that it has attracted very little interest from potential investors or buyers, leaving its hopes over the past year largely pinned on negotiations between the GOJ and the Housing Bank. Housing Bank Executive Director Ahmed Abdel-Fattah still claims that the bank will take over PIB if the GOJ's terms are good enough, and private sector bankers interested in the fate of PIB, such as Hadid, are not discounting this possibility. However, both CBJ Governor Touqan and Deputy Governor Faris Sharaf have indicated in recent meetings with Emboffs their inclination to recapitalize the bank in a manner similar to that employed in the case of JCB. This inclination appears to have leaked out recently, and PIB's stock price has risen dramatically over the past month.

19. (C) Nonetheless, considerable uncertainty remains. It would take a massive infusion of cash to put PIB anywhere near the minimum capital requirement, and it would be hard to find a partner willing to put so much cash into a bank with a reputation and balance sheet like PIB's. Hadid says that the CBJ is currently exerting strong efforts to collect PIB's JD 100 million (U.S.\$141 million) in outstanding debts, with a goal of getting 60 percent, which it hopes will in turn attract other investors. But such a strategy is unlikely to gain the necessary assets in the short run. The CBJ officials, recent statements to Emboffs about planning a recapitalization for PIB would only make sense if the CBJ plans to drastically reduce the minimum capital requirement for PIB or if the SSC plans to anchor this new recapitalization as it did for JCB.

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COMMENT  
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10. (C) While the resurrection of JCB seems at this point a substantial success and the market seems optimistic about prospects for a re-launch of PIB, the fates of the two banks represent the triumph of expediency over principle in the Jordanian banking sector. Jordan's bank regulators and sectoral analysts have long complained about the fragmentation of the sector, where almost thirty small banks fight to increase their share of a small market in which over two-thirds of the assets are held by the three largest banks. In 2002, the CBJ raised the minimum capital requirement to JD 40 million (U.S.\$56 million) with the unstated purpose of forcing consolidation in the sector as banks would merge to avoid dissolution (Ref B). The application of this rule has already been repeatedly delayed, and no banks have merged as yet. The relaxation of these rules in the case of JCB is a sign to other banks not to take them seriously.

11. (C) If the bailout/recapitalization of Jordan Gulf Bank was unwelcome news to those who had hoped for a strong GOJ signal that the cycle of moral hazard was over, a PIB bailout will be even more unwelcome news. One of the smallest and weakest banks in Jordan well before the Shemaileh scandal, PIB is known in the banking community as a bank with corrupt staff and a dodgy overall reputation. Its assets are so discounted that they are practically nonexistent even today. If the GOJ cannot let PIB fail, it cannot let any bank fail.

And if the market knows that the GOJ will never let an ailing bank die, the impetus for banks to consolidate, increase internal controls, and improve their business models will be that much weaker.

HALE